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November 14, 2006

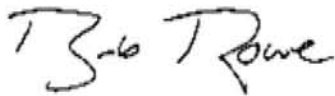
Ms. Marlene H. Dortch, Secretary
Federal Communications Commission
445 Twelfth Street, SW
Washington DC 20554

Re: WC Docket No 05-337, CC Docket No. 96-45 – *Ex Parte* Presentation

Dear Ms. Dortch:

On November 14, 2006 representatives of ITTA, OPASTCO, the Western Telecommunications Alliance, CenturyTel, Embarq, TDS and the undersigned had an ex parte meeting in the above-captioned proceeding with two members of the Federal-State Joint Board on Universal Service, Commissioner Ray Baum of Oregon and Commissioner Larry Landis of Indiana. The attached document was provided to Commissioners Landis and Baum.

Sincerely,



Robert C. Rowe
Senior Partner

cc: Hon. Ray Baum, Hon. Larry Landis



Fall 2006

WC Docket No. 05-337

CC Docket No. 96-45



INDEPENDENT TELEPHONE & TELECOMMUNICATIONS ALLIANCE

- CenturyTel
 - <http://www.centurytel.com>
- Commonwealth Telephone Enterprises
 - <http://www.ct-enterprises.com>
- Comporium Communications
 - <http://www.comporium.com>
- Consolidated Communications
 - <http://www.consolidated.com>
- Embarq Corporation
 - <http://www.embarq.com>
- FairPoint Communications
 - <http://www.fairpoint.com>
- Iowa Telecommunications
 - <http://www.iowatelecom.com>
- Madison River Communications
 - <http://www.madisonriver.net>
- Matanuska Telephone Association
 - <http://www.mta-telco.com>
- TDS
 - <http://www.tdstelecom.com>

- Introduction and summary
- Mid-size company background
- Framework for analysis
- Candidate goals
- Problem analysis
- Candidate solutions
- Auctions
- Data supplement – CETC funding growth

Summary

Background

Framework

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CETC
Growth

"In my view, competitive ETCs seeking universal service support should have the same 'carrier of last resort' obligations as incumbent service providers in order to receive universal service support. Adopting the same "carrier of last resort" obligation for all ETCs is fully consistent with the Commission's existing policy of competitive and technological neutrality amongst service providers."

-Then-Commissioner Kevin Martin
Dissent in Virginia Cellular (2004)

- Midsize carriers serve a representative cross section of all types of markets and households in 50 states. They are well-positioned to play a leadership role in the reform process.
- Universal service must be reformed to deliver the promise of a reliable network capable of providing a broadband future for all Americans, regardless of where they live.
- A predictable, sufficient and sustainable universal service system is the best solution for bringing advanced services, technologies and prosperity to rural markets.
- The wireline network is the backbone on which all other services and emerging technologies are ultimately delivered.
- Midsize companies continue to be leaders in deploying new and advanced services utilizing wireline, wireless and IP platforms to meet the evolving needs of our customers in some of the most rural sections of the Nation.
- We should pursue universal service reform initiatives that modernize the program for the future by aligning disbursement criteria with service, commitment and a focus on broadband-enabled, reliable networks.

Executive summary

- Effective reform should be
 - Grounded in analysis
 - Likely to achieve their objectives
 - Sustainable
 - In the public interest
- Midsize carriers provide high quality basic service, access to advanced services, COLR commitment
- USF support to CETCs is the primary driver of incremental fund growth
- Support should be based on the ETC's or CETC's own costs
- Specific, actionable and constructive proposals have been offered in this proceeding, which the Joint Board should recommend

■ Mid-size company background

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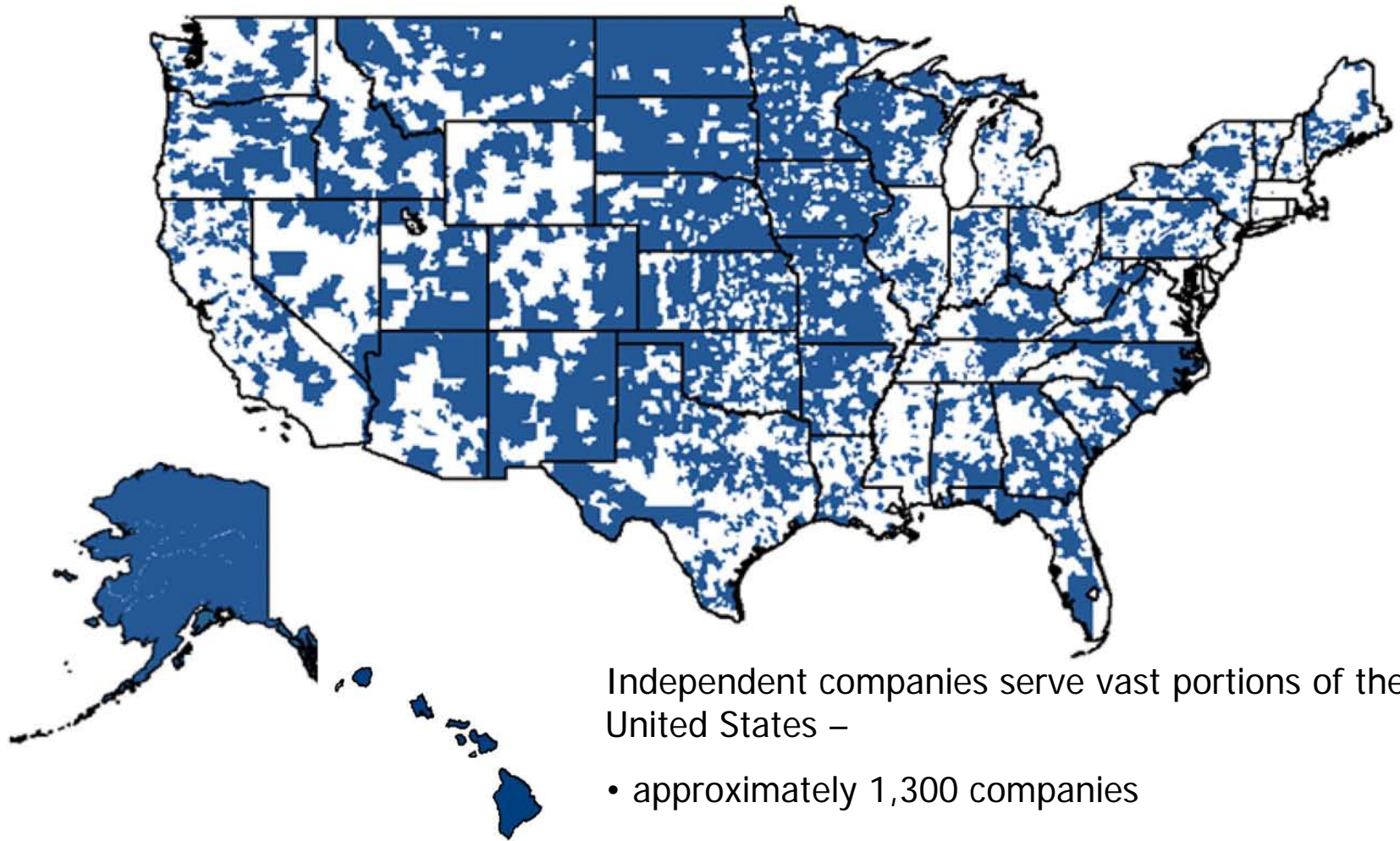
Auctions

CETC
Growth

Midsize carriers are meeting legal and public policy goals

- Midsize carriers operate small companies that provide service to mostly rural areas
- Investment incentives require rational and predictable universal service policies
 - Over 70% broadband coverage in Midsize/rural independent service areas

Independent telephone company service territories



Independent companies serve vast portions of the United States –

- approximately 1,300 companies
- sparsely populated with few urban areas to average costs

Company characteristics

- Lack scale and mixture of customers of Bells
- Low population densities – approximately 1/10th customer density of RBOC territories
- Vast majority of exchanges served are fewer than 5,000 access lines per exchange
- Experience declines in access lines, access revenue, and USF support

- The Midsize network is a part of the National telecommunications network– economically and functionally
- Advanced and emerging services rely upon the wireline network
 - VoIP, wireless and other new services will not work without underlying wireline network

■ Carrier of Last Resort

- The COLR is not simply the carrier to use when all others have left the market; *it is the carrier that stands ready to serve where no one else will enter*
- COLRs make decisions based on COLR obligations
 - Specific, predictable, and sufficient funding is critical for strong investment incentives in rural markets and relies upon rational and predictable Universal Service policies

■ Framework for analysis

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Reforms must be achievable

- Policy goals should be clearly stated
- Problem analysis should be rigorous
- Focus on solutions that are:
 - Politically adoptable
 - Likely to achieve the intended goals
 - Sustainable – remain effective as conditions change
 - Recognize the point at which reforms are commencing
- Incorporate feedback mechanisms to adjust & improve based on time & experience

Framework for achievable reforms



Source: Balhoff & Rowe, LLC

■ Candidate goals

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History of universal service policies

- 1934:
 - that all people should have access to “rapid, efficient, nationwide . . . communications services with adequate facilities at reasonable charges”
- 1996:
 - broadened principles include education, health care, and affordable access
- 2006:
 - universal service overcomes technology costs and market realities to bring service to people and areas that would otherwise be underserved

Goals for High Cost Fund

- Network focus
 - Support investment to better serve customers
- Customer focus
 - Benefit from service availability & affordability
 - Comparable services and rates
 - Limit exposure to harm from high risk “solutions”
- Carrier of last resort
 - Support service uneconomic to provide but required by policy goals
- Robust network for multiple uses
 - “No barriers to deployment” of advanced services (Rural Task Force)

Implications of changes to USF mechanisms

- Diminished predictability yields diminished incentive to invest
- Reductions will mean that network deployment initiatives may fall short in rural areas; someone, somewhere, has diminished service
 - *"We need a broadband strategy for America. . . . Combined with an overhaul of our universal service system to make sure it is focusing on the needs of broadband . . ."*
 - – Michael J. Copps, "America's Internet Disconnect," Washington Post, Nov. 8, 2006

Reforms must meet statutory and public policy

■ Midsize carriers:

- provide access to advanced services
- wireline network leveraged to support broadband and IP-enabled services; critical infrastructure for last-mile wireless networks -
- not a “legacy network”

Reform must be grounded in Act, but look to future

- Encourage future investment and recover prior investment
- Cannot remedy systemic problems by depriving access to high quality service at just, reasonable, and affordable rates
 - Carriers' ability to serve as COLR
 - Continued investments in and deployment of robust networks capable of supporting multiple services in rural areas

- Problem analysis
 - CETC-driven fund growth
 - Rural financial challenge

Summary

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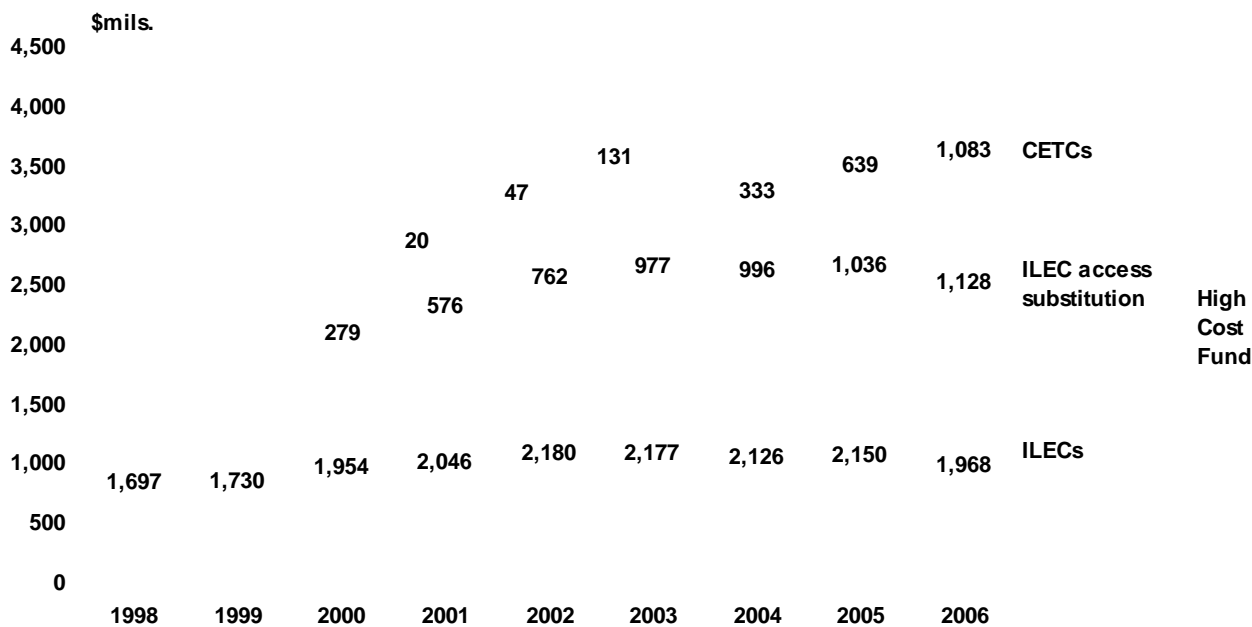
CETC
Growth

- Growing HCF distributions
- Historic growth in ILEC component based on “one-time” shift from implicit support in access to explicit in USF
 - Negative growth in ILEC funding in recent years
- Dynamic growth in payments to wireless CETCs
 - Unclear purposes
 - “Identical support” per line, regardless of cost
 - Uncapped CETC support
 - Funding multiple “competitors”
 - Poor accountability
- No match between support and program goals/cost of providing services

Access reform revenue neutral to ILECs

- Congress mandated implicit (access) funding be made explicit (USF)
- FCC implemented access reforms
 - 2000 (price cap carriers)
 - 2002 (rate-of-return carriers)
- Excluding access replacement, ILEC USF support is virtually flat
 - 0.12% avg. annual growth rate since 2000
 - < 2% avg. annual growth since 1998
- ILECs continued to receive approximately the same support funding – no incremental benefit
- CETCs began to receive incremental funds – windfall (had not received access previously)

Understanding Access Payment Replacement (Excluding CETC access receipts)



Source: USAC FCC filings; Balhoff & Rowe, LLC

- *Current* fund growth associated with increase in CETC funding; many wireless carriers
 - So far, largest CMRS carriers (*e.g.* Verizon, Cingular) have largely refrained from seeking CETC status, but pressure is mounting
- Under “identical support rule” CETC receives access-replacement support, although they did not receive access or incur the costs related to incumbent operations
- Confusion over universal service purposes – promote rural service, promote competition, or both?

Support not now aligned with need

- Support should be based on each company's own costs:
 - "Portability" of support is inefficient and sends improper market signals
 - Some carriers receive support in excess of cost (wireless CETCs) while other carriers do not recover appropriate share of their investment (RLECs)
 - Wireless not required to "prove costs"
 - ILECs unable to fully recover investments because of statutory cap on HCF and negative growth factor

Rural Financial Problem

- Costly to provide service in rural regions
 - Low density
 - Long loop lengths
- B&R Texas study not yet published
- Methodology involving financial data study based on . . .
 - “Supported services” only (revenues, costs, investment)
 - Actual revenues received for provision of these services
 - FLEC (12 kft loops – no costs for broadband-capable plant)
 - Data set
 - Over 100 Texas wire centers
 - Approximately 375,000 lines
 - Analyzed financial performance of wire centers in data set
 - Segmented into ROI groups (negative, 0%-10%, >10%)
 - Sub-wire center analyses of financial performance

NOTE: “Supported services” revenue streams that are included in analysis consist of Basic Area Local Revenue, End User Common Line (excluding USF surcharges), Carrier Common Line, Switched Access (including CALLS support), IntraLATA Toll, and High Cost USF where indicated.

Town Center vs. Outside of Town

Typical Wire Center Service Area

"Town Center"

Served directly
by Central Office
(CO) switch

"Outside of Town"

Distance from CO too
great to be served directly
(more sparsely populated
and longer loops)

- Fundamental goal – to better understand challenges in serving rural customers based on sub-wire center financial & competitive factors
- Studied "Town Center" regions, close enough to the CO (less than 12,000 feet) to be served directly, versus "Outside of Town" regions
 - CO typically placed in population centers – higher density, lower cost to serve
- Sub-wire center data are key to understanding . . .
 - Economics of serving differing geographic regions (in terms of density, costs, investment, etc.)
 - Why and where wireline competition is occurring, and where it is not
 - Role of explicit support mechanisms

Cooper TX Investment Overview



Overall Wire
Center
Investment

\$3,630

City Center
Investment

\$1,420

Outside City
Investment

Cooper Texas

\$10,300

Source: Embarq

Central Office
Service Locations
Wire Center Boundary



Cottondale FL Investment Overview



Wire Center

Total Lines Served

1,552

Investment per Line

\$5,520

City Center

Total Lines Served

660

Investment per Line

\$2,740

Outside City

Total Lines Served

892

Investment per Line

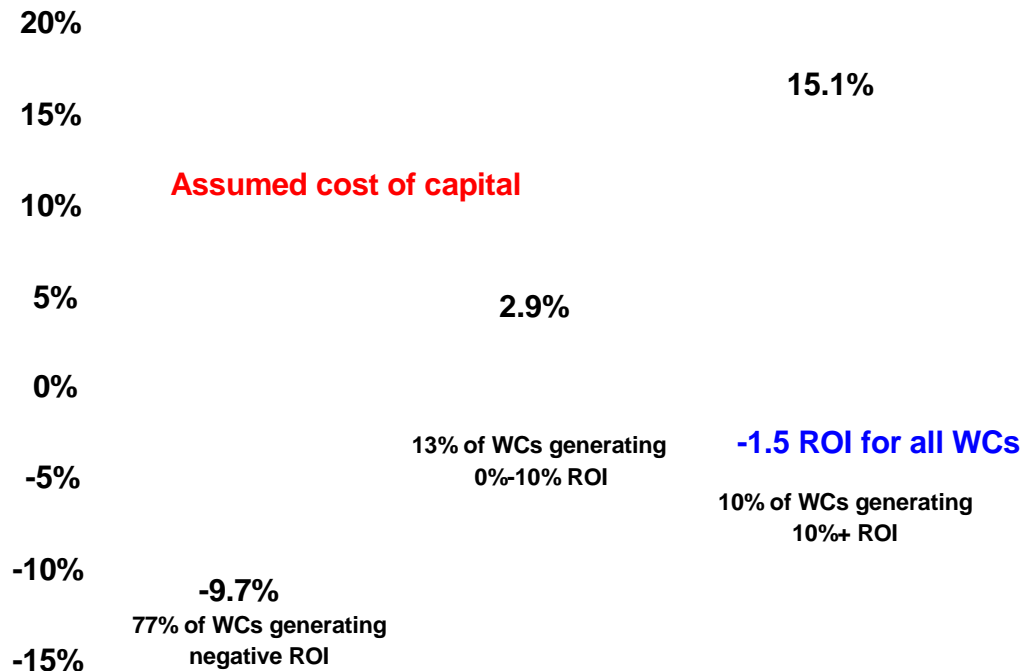
\$7,590

Source: Embarq

Central Office
Service Locations
Wire Center Boundary

Without USF, Rural Service At Risk

- Excluding USF receipts, combined ROI for all wire centers studied is negative
- Wire centers generating returns below assumed 10% cost of capital represent a large percentage of WCs, lines and investment
- Outside of town uneconomic regions would be/are unlikely to attract incremental investment from rational competitive operators
- Quality/availability of service for these consumers put at risk
- Even with USF payments, combined ROI is below 10%



Source: Sampled Texas companies; Balhoff & Rowe, LLC.

- Rural regions require high network investment
 - Density and loop lengths are major cost drivers
 - Maintenance costs are also important
 - Challenges related to advanced services
- Competition is apparently NOT occurring in remote regions which serve 15%-20% of rural carriers' lines, i.e. outside of town, areas with no towns
- Support is critical if regions are to be served

■ Candidate solutions

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Candidate solutions

- Target solutions to identified problems based on facts and analysis
- Clarify HCF goal as supporting networks capable of providing “reasonably comparable” urban and rural services
- Create relationship between support and COLR responsibilities
- Base support on recipient’s own costs

■ CETCs

- Convert to own cost rather than “someone else’s costs”
- Clarify purposes of CETC program – not to support otherwise uneconomic competition
- Revise Guidelines to ensure standards substantively similar to those faced by incumbent COLRs
 - E.g., ILECs receive support as reimbursement for investments made two years earlier
- Limit number of CETCs in an area
- Explore new mobility program as an element of universal service, funded from the common pool as are other universal service programs (e.g., Rural Health Care)

■ ILECs

- Revise NACPL formula so that line counts do not drop below zero for the rural fund
- Support more explicit targeting of support
 - Disaggregation below the wire center may make more sense now than when examined previously, as ability to average costs across and within wire centers has declined
 - Do not consolidate wire centers, which would move in the opposite direction of greater targeting
 - Revise Parent Trap rules to allow greater support for actual investment in acquired distressed lines

■ Auctions

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Background on auctions

- Auction proposals made frequently over the last decade, including in FCC proceedings
- Specific design questions must be answered for auctions to be implemented and be effective
 - See ITTA Comments, Dkt. No. 05-337, Table 1, p. 36
- Auctions in unserved areas are not good comparisons for areas with existing network infrastructure
 - In unserved areas, no one has made the investment
 - Inefficient where good network exists
 - Potentially disrupts service to customers

■ Customers

- Risk loss of critical infrastructure and service if all necessary conditions not adequately incorporated
- Shifting to new, untried model; consequences could be dire
- Service expectations likely to evolve over auction term, e.g. E-911, wideband

■ Capital providers

- Likely to increase industry uncertainty – rising cost of capital
- Possible stranded investment, could deter future needed investments
 - Investments problematic in later years of auction term
- May jeopardize existing loan covenants

■ Incumbent carriers

- Stranded network investment
- Regulatory parity required for level playing field

■ Policymakers

- Unless applied solely to wireless CETCs, solution not directly related to source of problem – growth in CETC support
- Implementation complicated
- Failures will be policymakers' responsibility

Auction decision tree

Auction issues

Legal	Investor	Customer	Carrier	Policy
<ul style="list-style-type: none">▪ 254 statutory requirements▪ Existing law▪ State law▪ Anti-trust	<ul style="list-style-type: none">▪ Potential to raise risk▪ Potential for arbitrage or under-investment▪ Problem of stranded investment	<ul style="list-style-type: none">▪ Deteriorating service prior to auctions▪ Potential for abandonment or failed service▪ Potential for lesser access to new services	<ul style="list-style-type: none">▪ Investment and depreciation cycles▪ Replacement of plant in orderly cycle▪ Justification of investment that outlives term▪ Under-investment in period before auction▪ Regulatory systems and costs▪ COLR risks and the former incumbent	<ul style="list-style-type: none">▪ Broadband investment▪ Funding for other emerging obligations▪ Resolution of state rate-of-return regulation▪ Service quality▪ Matching goals with incentives

Possible auction applications

- Consider narrowly tailored “pilot program” in order to minimize error risk, gain valuable implementation insights, and test the concept
 - Could be applied to “unassigned” or “abandoned” areas where no carrier currently obligated to serve
- Separate wireless CETC auction may be less problematic
 - Directly addressing HCF growth problem
 - More consistent with complementary nature of wireline and wireless services
 - Can construct more specific and appropriate standards for mobility service
 - Lower error risk / implications of failure if viable wireline COLR remains in place
- If broadly adopted, an ILEC losing an auction should be completely freed of regulatory obligations, under both federal and state law and regulation
 - Transition needed to account for prior investment currently being recovered
- If the Joint Board elects to pursue auctions further, it should in the meantime proceed with other actionable recommendations in this docket

Summary recommendations

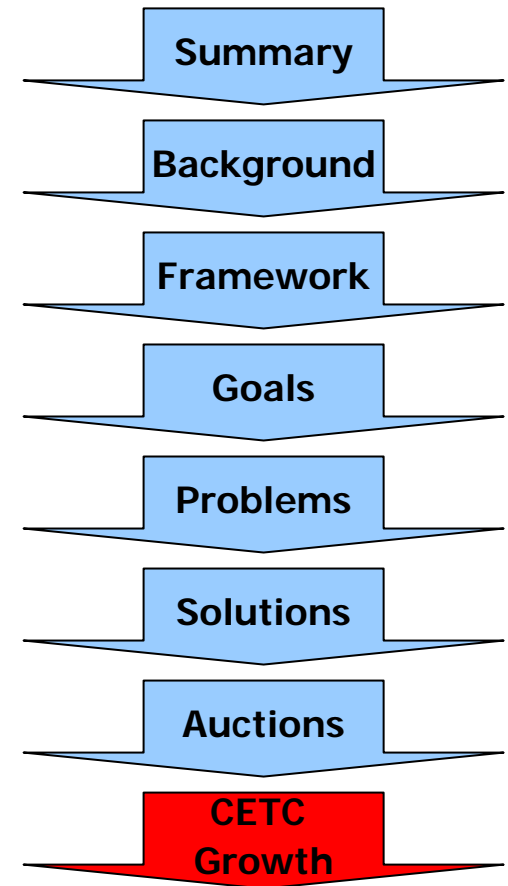
- The Joint Board should consider:
 - Support based on the recipient's own costs
 - Tightening the current certification standards; which is in the interest of all ETCs and CETCs over the long run
 - Modifying the rural growth factor to insure that carriers are able to continue investing in modern and reliable networks;
 - growth factor should never be "zero"
 - Future access charge replacement mechanisms be distinguished from High Cost Fund support
 - Greater targeting or disaggregation of support to the highest cost areas
 - A separate "mobility" fund, supported by the unified collection mechanism as are other USF programs.
 - Targeting auction experiments on, for example, unassigned or abandoned territories, or as part of creation of a new mobility fund

Modernizing Telecom Policies: A framework for solutions

- Universal service reform must be grounded in statute and clear principles that assure support for the National network wherever it is deployed
- The wireline network that has benefited from USF support is the basis upon which wireless, advanced, and emerging technologies rely
- Midsize carriers have historically been and continue to be committed to deploying and offering new and advanced services at reasonable and affordable rates to all of their customers
- Growth in the USF stems mainly from multiple CETCs
- Progress toward a broadband future must not be compromised by measures intended to correct imbalances created by other circumstances
- The integrity of the universal service program depends on a periodic reexamination of the USF structure to ensure that the legal and public policy goals are met by the current requirements

LZ8 Take away message should be up front as well...bookend as executive summary slide and summary slide.
Lisa Zaina, 11/7/2006

- Data supplement –
CETC funding growth

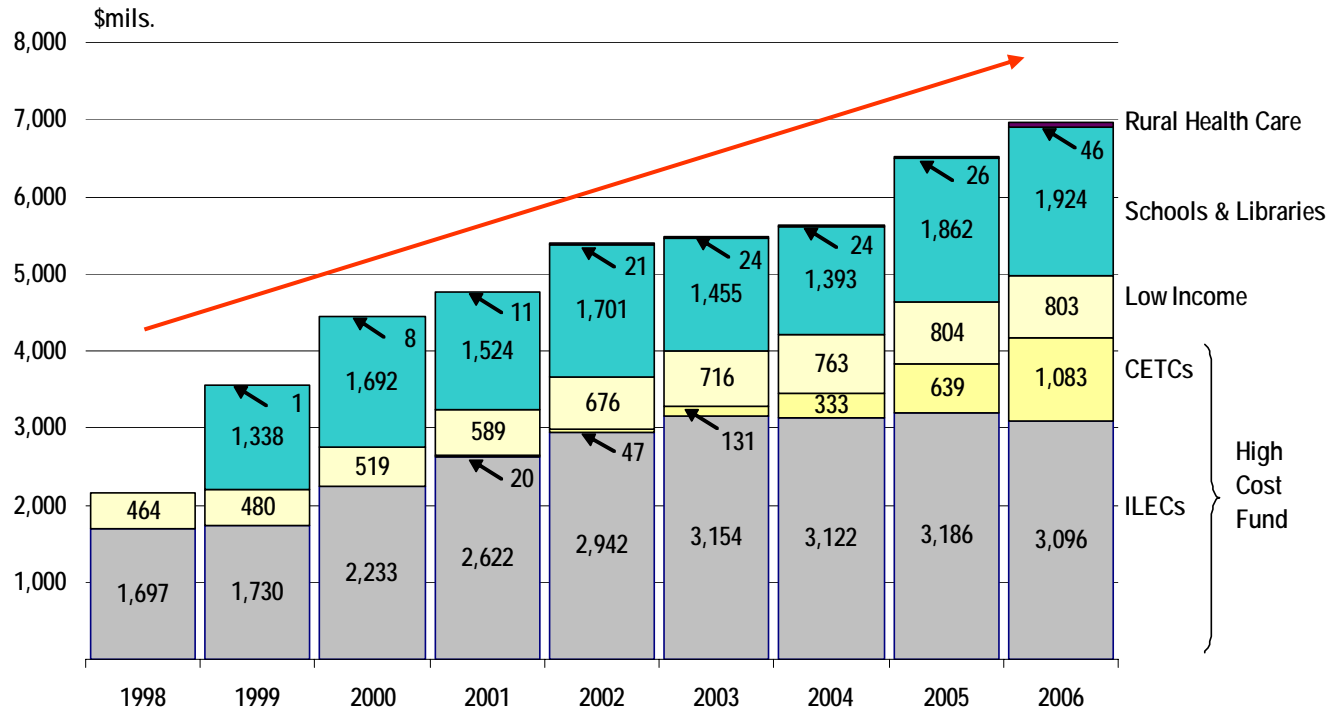


CETC funding growth

- Possibility of more than one support recipient (Section 214(e)(2))
 - States “*may*” certify more than one carrier in areas served by RLECs and “*shall*” certify more than one in other areas (Bell-served)
 - All must be “consistent with the public interest”
 - States feel obligated to certify multiple CETCs in urban areas even if it’s not in the public’s interest
- Subsequent agency decisions opened the floodgates
 - Current situation not reasonably foreseen by Congress or FCC
- Joint Board’s responsibility to recommend actionable modifications based on experience and analysis

CETC funding growth

Federal Universal Service Fund Elements

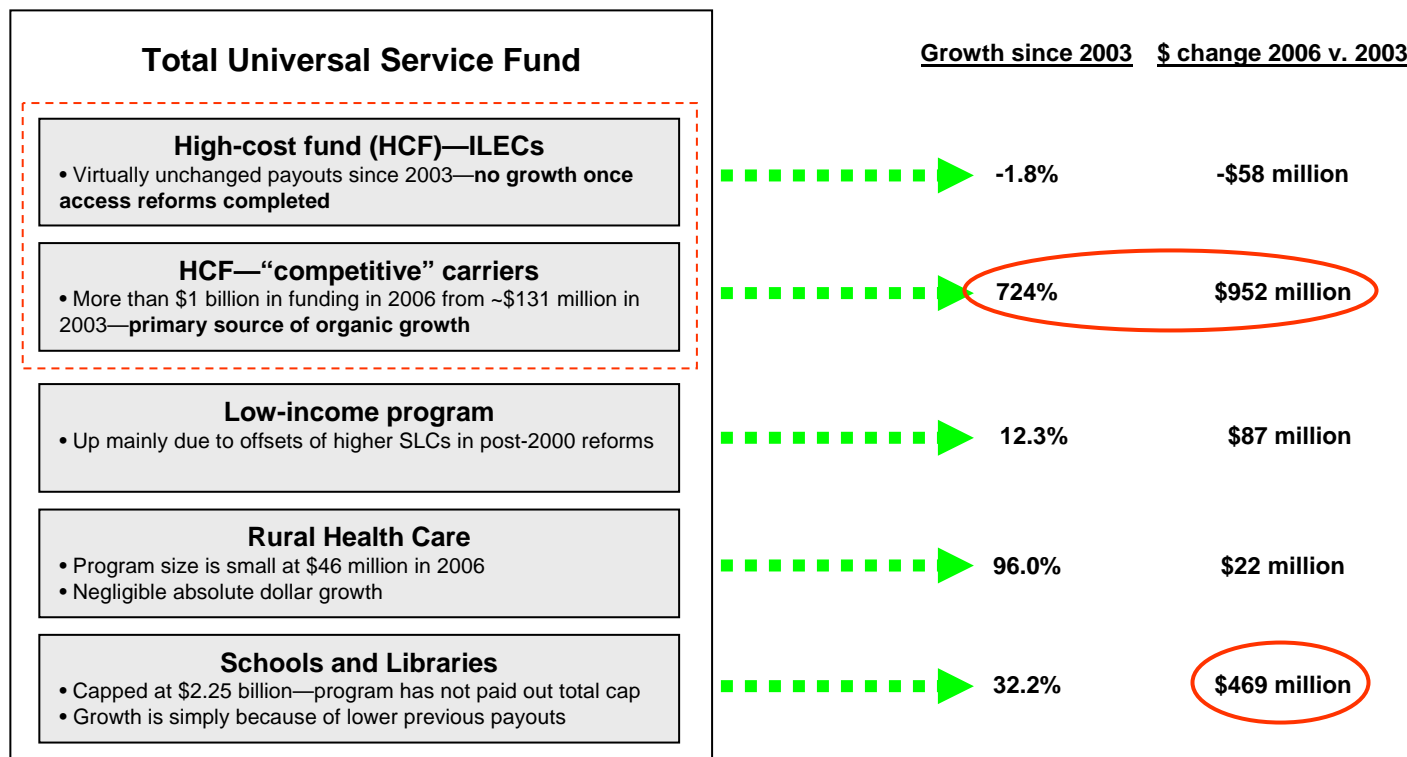


Source: USAC FCC filings: Balhoff & Rowe, LLC.

■ Sources of growth

- One-time program changes, such as creation of Schools & Libraries (1999)
- Shift from intercarrier access payments to explicit support mechanisms (2000-2002)
- Emphasis on support for wireless Competitive Eligible Telecommunications Carriers (CETCs) (ongoing)

CETC funding growth

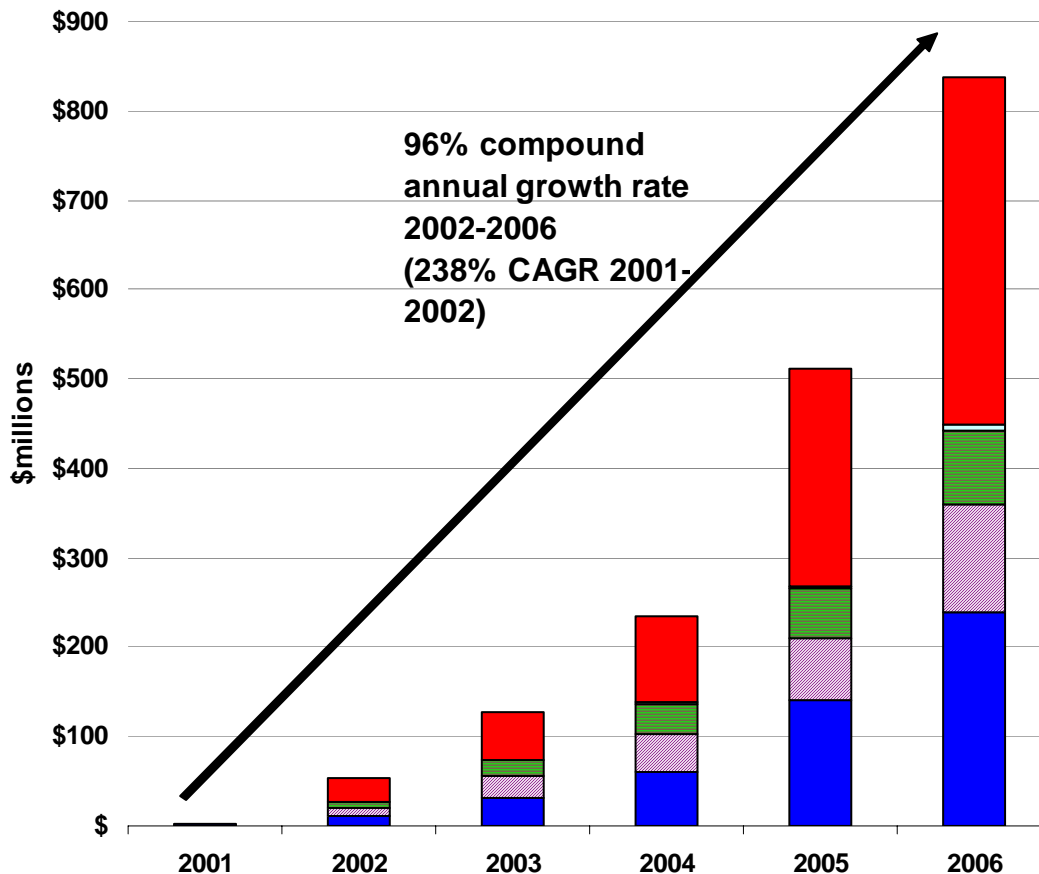


Source: Balhoff & Rowe, LLC

- USF payments in 2006 approximately \$1.47 billion greater than in 2003
- Growth in payouts (post-access reforms) has been driven by ...
 - \$469 million increase in the Schools & Libraries program, accounting for approximately 32% of the increase (total 2006 payments still below cap)
 - \$952 million increase in payments to CETCs, accounting for approximately 65% of the total increase in funding – growth to continue absent reform

CETC funding growth

CETC Annual Funding by Fund Element



- Funds to CETCs exploding
 - 96% CAGR 2002-2006
 - Approximately 61% growth 2005-2006
 - Access replacement is approximately 46% of CETC total receipts in 2006 (*composed of Interstate Common Line Support, Interstate Access Support & pre-2005, Long-term Support*)
 - Wireless CETCs did not receive access payments prior to reforms
- Access replacement
 □ Other
 ■ Local switching support
 ■ High cost model
 ■ High Cost Loop

Source: Universal Service Administrative Company Quarterly appendices HC01 (only eligible and ETC-approved funding); Balhoff & Rowe, LLC.